Into the Breach

Salam Fayyad and Palestine

INNOVATIONS FOR SUCCESSFUL SOCIETIES

REMAKING A MINISTRY: MANAGING FINANCE AT THE PALESTINIAN AUTHORITY, 2002 – 2005

Jennifer Widner and Tristan Dreisbach drafted this case study based on multiple conversations with Salam Fayyad in Princeton, New Jersey, during 2019, as well as other interviews conducted in Washington, D.C., Jerusalem, and the Palestinian cities of Ramallah, Nablus, and Jericho in June and July of the same year. The case is part of a series on state building in Palestine, 2002–05 and 2007–13. Case published March 2022.

SYNOPSIS

When Salam Fayyad became finance minister of the Palestinian Authority in June 2002, the interim government was starved for cash and faced strong internal and external pressure for reform. To ensure the government could manage revenues and expenditures with fidelity, Fayyad had to improve the functioning and the professionalism of the ministry. He moved quickly to revise core procedures and change the organization's culture. As he did so, he also began to transform the ministry from an organization based on personal allegiances into one based on institutional policies and standards. Success in that arena during the next three years depended on building coalitions to maintain support for reform as well as marshaling capacity within the ministry itself—by reshaping expectations, centralizing control, unifying geographically divided operations, and fostering talent.

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INTRODUCTION

On his second day as Palestinian Authority (PA) finance minister in June 2002, Salam Fayyad was under curfew, stuck in Ramallah—seat of the *muqataa*, President Yasser 's headquarters. In retaliation for a suicide bombing that had killed 30 Israelis on March 27, the Israel Defense Forces had rolled tanks into West Bank cities and announced that they would restrict people to their homes.[1] In April, they had laid siege to the *muqataa*, forcing cabinet ministers to conduct the government's affairs without normal access to their offices and staffs. [2]

Unable to return to his home in East Jerusalem or to reach the ministry's main office in Gaza because of the curfew, Fayyad booked a room at a modest hotel—the kind of place he considered appropriate for someone whose job was to restore the PA to financial health—and he began to plan. Only a few days earlier, he had agreed to leave a lucrative post as director of the Arab Bank's Palestine branches—a position he had held for only a few months—in order to help lead a reform program that had broad support from the Palestinian Legislative Council and within the Palestine Liberation Organization, the umbrella political coalition that created the PA's institutional framework.

Finance Minister Salam Fayyad conferring with Yasser Arafat midway through the Ramallah siege, September 19-29, 2002, a few months after he became minister.

"I really felt the hugeness of the moment, to be part of building your own country," Fayyad said. The PA's situation "looked desperately impossible both politically and technically."

Desperately impossible was an apt description, according to an analysis by Fayyad's former colleagues at the International Monetary Fund (IMF), where he had served from 1996 to 2001 as resident representative to the Palestinian territories. When the broad uprising against the Israeli occupation, known as the second intifada, began in late 2000, Israel withheld the taxes and fees it collected on the PA's behalf (commonly referred to as *clearance revenues*)—about 60% of the PA's total revenue—and imposed restrictions on movement that crippled government finances, trade, and Palestinian mobility to jobs.[3] The Palestinian economy contracted abruptly. In 2001, the year before Fayyad became finance minister, growth in gross domestic product was negative 15%.[4] Real gross national income shrank by 16.2%[5]—which was 20% in per-capita terms—in the context of the occupied territories' rapidly growing population. The government ran an estimated US$826-million deficit in 2001, financed mainly through external grants, bank borrowing, and payment arrears to suppliers and

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government workers.[6] And the PA struggled to provide basic services such as health and education.[7]

Israel's response to the intifada, known as Operation Defensive Shield, was not the only cause of the PA's predicament, though it was a major contributor. It was no secret that Arafat and his cabinet officers also had failed to move the occupied territories—Gaza and the West Bank—closer to statehood, as envisioned in the 1993 and 1995 Oslo Accords. Since the late 1990s, both Palestinian legislators and external partners had called for improved management, especially in the finance ministry.

When Fayyad served as IMF resident representative, he worked with Arafat to develop a presidential decree, issued in January 2000, to launch a financial overhaul along the lines the legislature had proposed. The PA released the plan, called the Economic Policy Framework, just a few months later but failed to follow through. There was internal resistance to changes to deeply entrenched practices, and the tentative steps Arafat took fell by the wayside when the intifada broke out later that year.

A group of eight leading legislators later drafted a new reform proposal, accepted by majority vote. Among other measures, they called for the resignation of the cabinet, appointment of a much smaller group of ministers, civilian control of a consolidated security service, creation of a single account for all government revenue, and a strengthened watchdog agency or inspector general.[8] More than 90% of citizens polled by the independent nonprofit Palestinian Center for Policy and Survey Research in May 2002 supported those ideas—at least in general form.[9]

With the impetus for reform high, Arafat recruited Fayyad for his skills and technical knowledge. Fayyad had a good sense of what needed to be done to bring the government to financial stability. The difficult question was, how to do it? As a start, Fayyad would have to reshape the finance ministry into a professional, functional bureaucracy, which would be no easy task.

THE CHALLENGE

The ministry Fayyad inherited was a far cry from a professional financial institution. It had existed for seven years, and Fayyad's predecessor had struggled to institute standard operating procedures, policies, and protocols. Lines of authority and job roles were unclear, and there was little transparency.

Though the institution was new and fragile, the stakes were high: if the government could not manage its finances with fidelity, then it would lack legitimacy, fail to deliver services to the people, risk losing international donor support, and weaken the case for statehood.

"I was petrified by the prospect of failure, which was a lot more imminent than anybody cared to think at the time," Fayyad recalled about his first weeks as finance minister. "It was a mission, not a job."

The first challenge was the absence of a tradition of rule-governed, impartial decision making. Most of the cabinet ministers and their deputies were former revolutionaries, and the PA was an organization of personalities and

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personal allegiances rather than of policies and procedures. Arafat himself expected ministers to seek his approval on nearly all significant decisions, in a replication of the way business had been done in the Palestine Liberation Organization. At the PLO, Arafat had managed political dynamics and an armed resistance. "He thought he was also able to manage an economy, administration, finance, and all these things," said Yasser Abed Rabbo, a longtime PLO leader who worked closely with Arafat and had returned from exile in Tunisia to join the PA.

The president's influence and control disrupted the lines of authority that would normally shape the operations of a finance ministry. "The minister reported to the president, the deputy minister reported to the president, and the assistant deputies reported to the president," said Jihad al-Wazir, who worked in the planning ministry in 2002 and later joined Fayyad as deputy finance minister. "They all felt they were empowered to do their own thing based on their relationship with the president."

A second, related challenge was the finance ministry's lack of clear procedures for handling core functions. Yousef al-Zamer, who served as deputy general director of the revenue and local governments directorate in the finance ministry when Fayyad arrived and who was one of the first employees hired in 1994, said a small team had opened the main office in Gaza. "The revenue and expenditure departments, one for Gaza and another for the West Bank, set up their own rudimentary computer systems to keep records, and they opened accounts at commercial banks," he recalled. But in those early years, the ministry had limited authority to manage the PA's finances. The line ministries, such as education or health, made decisions about expenditures without the finance minister's knowledge, al-Zamer added.

As IMF resident representative, Fayyad had seen the difficulties the ministry faced in its early years and recalled his predecessor's office as being noisy, stacked high with paperwork, and beset by crowds of people waiting to see the person in charge.

Ministries also executed payments according to subjective judgments, said Muna Masri, director of control and audit when Fayyad arrived. In the absence of clarity and transparency, opportunities for financial mismanagement abounded. In some instances, money was diverted for purposes other than those specified in agreements with the legislature, the IMF later concluded, although much of it was nonetheless traceable to other official purposes.[10] That lack of accountability had become a sticking point in relationships with donors, in peace negotiations, and in public opinion. A May 2002 Palestinian Center for Policy and Survey Research poll showed that 83% of respondents agreed that PA institutions were corrupt.[11]

A third implementation challenge arose because procedural changes were not neutral, technical matters in this context; instead, they affected the pocketbooks of powerful people. Fayyad "faced a problem at the political level," said al-Zamer. The new finance minister risked becoming an enemy of those who benefited from the lack of expenditure controls and transparency. Though

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he had Arafat's political support, Fayyad said, he was keenly aware of being labeled as an outsider, a technocrat with a foreign PhD who had returned as part of an international organization. Either he had to become a coalition builder or he would achieve little.

The fact that many Ministry of Finance functions had two parallel offices, mirroring the geographic split of the West Bank and Gaza, presented a fourth problem. Only a few years earlier, most offices had been located in Gaza. When Arafat began to spend more time at his compound in the West Bank city of Ramallah, however, the center of the PA gradually started to shift. At the time that Fayyad was appointed, the finance minister and core operations were still headquartered in Gaza, but some of the other units had moved.

Human resources posed a fifth challenge. Fayyad now headed a ministry whose own size and structure were unclear, with no organizational chart and uneven capabilities. He could not appoint additional people, given the PA's financial straits. Instead, he would have to figure out who had the skills and commitment he needed and give them responsibility. "The accounting staff had earned their degrees from reputable programs," al-Wazir said. "Many of them were civil servants previously under the Israeli administration." He added: "When the PA came, a lot of new graduates joined and then some PLO people, who had done accounting in the PLO. They had a track record with Arafat; Arafat knew them; but they had a revolutionary mentality, not a state-building mentality."

Masri underscored that concern, saying that the ministry began with very few workers and that there was sometimes a "minimum of consideration" in crafting job descriptions and hiring criteria as employment ramped up. However, as a group, Palestinian civil servants were either better educated than or at least on par with their counterparts in many countries in the region. "We have the same percentage of people who graduated from university as a European country does," said al-Zamer. The challenge was to identify and empower the capable.

A sixth challenge arose from the PA's coerced dependence on Israel and on aid provided by external partners. Consumption taxes, including customs duties and a value-added tax (VAT) on third-party imports (commonly referred to as *direct imports*), were collected at Israeli ports or other border points and transferred to the PA minus a 3% administrative fee. In addition, the government of Israel transferred the VAT and excise taxes levied on Palestinian imports from Israel itself, after subtracting both the 3% administrative fee and the corresponding proceeds, vastly smaller, from taxes on goods and services Israel imported from the Palestinian territories.

Under an agreement known as the Paris Protocol, adopted in 1994 as part of the Oslo peace accords, the PA had adopted Israel's single-rate VAT and introduced its unified invoice system. Those steps constituted a de facto customs union with Israel. In monthly meetings, PA officials sat with their Israeli counterparts to vet the receipts and establish the net amount to be

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Text Box 1: The PA's 100-Day Plan

Crafted from June 9, when the president announced the full cabinet, to June 20, the plan spanned finance, the judiciary, and security.[1] It set bold objectives for the period ending October 31. Fayyad's own commitments included:

- Reform of finance ministry operations to reestablish the ministry's credibility
- Consolidation of all PA revenues into a single treasury account
- Creation of a Palestine Investment Fund to consolidate, reorganize, and manage the PA's commercial enterprises[1]
- Steps to limit the expansion of public employment
- Unification of the public payroll under authority of the finance ministry
- Creation of a modern pension system
- Development of an internal public audit system and appointment of auditors, including an independent external auditor
- Steps to strengthen the independence of the auditor general role
- Implementation of an enhanced budget preparation process
- Issuance of monthly expenditure reports
- Preparation of the 2003 budget in order to meet deadlines in a timely manner

The scale of the program was daunting, and it was clear from the outset that some of the objectives would take years to complete, but the idea was to launch change and provide clear goals.

transferred. International bank transactions also went through Israel's check clearing house.[12]

Until the start of the intifada and the suspension of that system, these arrangements correlated with significant improvement in the PA's ratio of tax revenue to GDP, which stood at 18% in 2000—well above the level of many other countries. But the policy also empowered Israel, placing its government in a position to withhold revenues the PA had earned. Fayyad might succeed in strengthening his ministry and in meeting the goals he had set, but he would not be able to sustain public support if Israel continued to keep the revenues, thereby making it impossible to pay salaries, provide services, and grow the economy. Aid donors would not help fill the gaps indefinitely. Adding to the difficulty of the task, reform of the ministry's bureaucracy had to proceed in tandem with other priorities that had been set forth in a 100-day plan (text box 1) and in the Palestinian Legislative Council draft plan.

Fayyad appreciated the urgency of finding solutions. The legislative council, which was dominated by Fatah, Arafat's political faction within the PLO, had left no doubt about the need for change. Moreover, the international climate had shifted. The terrorist attacks on New York's World Trade Center towers had taken place only 10 months earlier, and the international community had mobilized to tighten financial controls around the globe.

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"The whole world was coming unglued, so it was not a time for niceties and diplomatic speak," Fayyad stressed. The PA's inability to control all of its revenues and expenditures no longer met with patience either at home or abroad.

FRAMING A RESPONSE

During his first days on the job, Fayyad began to assess the weaknesses and strengths of the ministry, which was in crisis: "a house on fire," he called it. The goals were, first, to put the fire out and then to devise rules and systems that would improve effectiveness and reduce any wrongdoing. "You don't have the luxury of saying the car needs to be fixed, so let's take it to the shop, and the PA stays closed for business until the repairs are done. You ride along, and you begin to introduce improvements as best you can," he said.

To enable the ministry to work better, Fayyad knew he had to address several basic organizational needs in addition to taking important steps like building a central treasury account, as envisioned in the 100-day plan. The steps included enlisting the support of ministry workers and laying out the tough job ahead; maintaining the backing of other influential people in the government, especially Arafat; taking de facto control of all significant ministry functions; unifying the ministry's separate operations in the West Bank and Gaza; bolstering ministry employees' capacity to handle greater responsibilities; and helping strengthen the legislature's ability to hold the ministry accountable.

The centralization of decision making would concentrate activity in Fayyad's hands for a time, but—counterintuitively—it was an essential intermediate step toward depersonalization of functions and the building of a competent and impartial institution. Fayyad planned to gradually redelegate authority along bureaucratic lines once stronger, uniform processes were in place and people with the right skills were in the right posts.

Fayyad believed that new work processes would reshape behavior—an approach that would reduce discord and create space for moving ahead on important goals. "Work processes translate decisions into something. They empower and disempower," he said.

"Let's not look back; let's look forward" was a key maxim that guided Fayyad's approach throughout. He said he did not want to cause unease at the ministry by shuffling personnel on his arrival, and he did not want to go to the president to seek his help to dismiss people who were poor fits. He aimed to avoid firing people for past malfeasance and instead proposed to direct them into new activities. He also wanted to set a model that others could emulate.

As Fayyad made his first steps, the International Quartet—comprising the United Nations, the United States, the European Union, and Russia—together with the IMF, the World Bank, Japan, and Norway set up an Independent Task Force on Palestinian Reform, with seven subcommittees to monitor and facilitate specific aspects of the 100-day plan, especially with regard to matters that required cooperation between the PA and Israel.[13] A finance subcommittee

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tracked progress at Fayyad's ministry and offered assistance in coordinating with external partners.

Fayyad had Arafat's tentative political support, which created space for him to move forward. Fellow minister Abed Rabbo said Arafat appreciated Fayyad's professionalism and his flexibility. To Arafat, Fayyad was "the man who came without any needs," Abed Rabbo added. "He liked that Fayyad did not belong to one of the factions, even to Fatah, the PLO faction that Arafat founded and controlled."[14] Sustaining the president's support in the face of politically difficult decisions would be crucial.

GETTING DOWN TO WORK

In mid June 2002, the conditions for making progress on Fayyad's reform agenda were inauspicious at best. During Israeli incursions into cities and the siege of the *muqataa* in April, much of the Palestinian Authority's infrastructure in the West Bank had been damaged. A *New York Times* report described "offices in ruin, files and hard drives gone."[15] Tanks were still in the streets of Ramallah. And curfews and closures made it hard for ministry personnel to reach their jobs during the first five weeks after Fayyad's arrival; the measures eased only partially thereafter.[16]

Setting expectations

Fayyad addressed ministry staff as soon as he was able to leave Ramallah and make his first visit to the headquarters in Gaza. He praised those who had led the ministry before him, said it was an honor to serve, and stressed that his mandate was to move "us"—the whole team—to the next phase. Launching the ministry, just seven years earlier, he called *Act One*. That first phase had required hard work, he said, acknowledging the efforts invested in crafting a legal and regulatory framework, setting up an economic administration, improving tax collection, and beginning to implement public investments.[17] He then pointed to the problems that had arisen and announced it was time for Act Two to begin.

"I said we would work together to assemble the elements of a well-functioning public finance system, a system consistent with having a state that rises to the aspirations of our people," Fayyad recalled. He focused on the shared Palestinian vision—statehood—and suggested big changes would have to happen at the ministry in order to attain that goal. But he also sought to reassure those assembled that unless and until he said otherwise, things would work as they had previously.

Fayyad concluded by explaining that after new systems were in place, he expected everyone in the ministry to comply with the revised rules and procedures. Those who declined to do so would find themselves marginalized, though not dismissed. That arrangement was not optimal from an efficiency standpoint, but it was an essential compromise in order to get things done. For the next two years, those who underperformed or failed to adhere to the new standards found themselves renamed advisers in charge of some sort of special

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project—not moved out of the ministry altogether but not given responsibility for a critical function either. Most also kept their titles.

In addition to explaining the mission and allaying fear that staff members might soon lose their jobs, Fayyad said, he wanted to set a tone and provide a model. First, he aimed constantly to reinforce his vision and mission—to remind people that the work they did was crucial for realizing the Palestinian goal of statehood and self-determination. He acknowledged that some of the tasks he asked people to do were time-consuming, tedious, and painstaking. The words of one of his own professors had stuck in his mind: "Peeling onions feels better when you are singing the national anthem."[18] And in this instance, it was easy to make that case. "This really is about us" became Fayyad's refrain: "It's about building a nation. It's about doing something for future generations. It is really important."

Fayyad also began to refer to government revenue as "the people's money" in order to instill a sense of community service.[19] To help reinforce such an ethic, he rejected most of the perks often attached to his own position. In addition to booking himself into a modest hotel when curfews made travel impossible, he rejected the offer of a Mercedes for trips between the ministry's offices and instead sought out a general-purpose automobile, settling on an aging green Hyundai that the mail couriers had used and that was missing its hubcaps. "It was the perfect vehicle for the minister of finance of an authority that says it is broke," he recalled.

Establishing clear expectations about working hours was also a priority. Fayyad said he arrived at the office early each morning out of necessity—he had a grueling schedule—but also partly because he wanted to set an example. One of his adages was: "If you are a minister, go to work before everyone else and do not relax. Be among the first to show up, and others will follow suit."[20]

Building support across the government

In 2002, despite international pressure and internal posturing, the PA's leadership had few clear advocates for reform. Legislative council economic committee chair Azmi Shuaibi and some of his colleagues demanded change, but many of their executive branch partners were slower to perceive the need and what it entailed, claiming the pressure was largely external. Fayyad and three other new ministers enlisted to implement the reform agenda had to steer a course that responded to the legislature's call for an overhaul and also built senior leaders' understanding and support.

A strong relationship with Arafat, who could influence other PA leaders, was pivotal. Fayyad saw the president every day during his first few months on the job, when many officials avoided visiting because Israeli forces had surrounded the headquarters, damaged facilities, and imposed curfews that were often difficult to work around. He said he genuinely liked the man, and he also recognized the need to sustain and strengthen the president's backing in order to defend his financial reforms from political interference.

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Although Arafat had a reputation for being obstinate, the president was also disposed to accept some changes. "He was not so stubborn" as people imagined, said Abed Rabbo. "Sometimes you could convince him. He could change his mind. There were times when he would change his mind, defend your approach, and then claim your approach was his idea."

In his communications with Fayyad, Arafat conveyed in the form of requests, not orders, the things he wanted to do. He would sometimes pencil "to do" or "to disburse" or "to help …" on an appeal or proposal someone had sent him and then turn it over to Fayyad, who perceived that the words indicated he had some latitude about how to respond. Fayyad said that on occasion, when dealing with senior politicians or other people of rank, the president prefaced his suggestions with the words, "Dr. Salam" These, too, were requests, not orders. In those instances, Fayyad said, he suspected Arafat perceived the issues but did not wish to involve himself in decisions his allies might not like.[21]

For his part, Fayyad said he tried to accommodate requests that were reasonable, and he trimmed or adapted some of them so as to avoid violating important principles or processes. (Arafat himself was notorious for cutting in half all budget requests people sent him.) Only occasionally did strong differences of viewpoint arise—for example, issues involving handling of the security payroll.

"When Arafat made a request and I didn't do what he wanted, I lived to tell about it," Fayyad said. The president had a soft spot for people of principle, he added, especially those who were "tough-minded" and willing to take risks.

With others in the government, Fayyad tried to take sensibilities into account. He said he knew many of his reforms imposed costs on fellow PA leaders, whose perceived statures were usually linked to the sizes of the budgets they commanded. To implement new policies or procedures, he tried to compensate for some of the impacts. [22] For example, if a reform reduced the budget of a ministry by requiring that it send the fees it collected to a central treasury account instead of keeping them as part of its own resources, he quickly tried to transfer some money back to that ministry through approved budget lines "so they wouldn't really feel the difference."

Fayyad also made a practice of meeting in person. Breaking with standard organizational culture, he began to visit people in *their* offices instead of receiving them at his. He said he found it easier to leave a meeting in somebody else's office than to tell someone in his own office that he had to leave, knowing that hours could disappear over coffee and cigarettes.

Sustaining legislative council support was also crucial. To appeal to the interests of election-minded legislators, Fayyad said, he tried to favor policy options that aimed to improve the lot of ordinary citizens even if he couldn't rapidly restore households to pre-intifada standards of living.

To avoid attracting attention that might bruise the egos of veteran PA leaders, Fayyad tried to stay below the media radar during his first months in office. When reporters contacted him for comments, he dodged them or offered only a few well-rehearsed lines, saying he wanted time to get his bearings and

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that he owed his colleagues respect and some deference for all they had attained. That obscurity was not to last, however, and visibility rapidly became a problem he had to manage.

Al-Wazir, Fayyad's deputy, concurred. "I think you can't have financial sector reform unless you have drivers for change, and that comes from the top." It was impossible to change everything, especially systemic corruption, overnight, he added. Instead, leaders had to build crucial institutions and insulate them from corruption, and that's what Fayyad was trying to do. And for that, he needed supporters—key people in the government who supported the work.[23] There were not enough of them, but some of them were in high places.

Centralizing control

"The challenge for Salam Fayyad was to take stock of everything that was going on in the ministry and ensure control by centralizing everything as a first step," al-Wazir said. Among the ministry's senior officials, rank did not necessarily correlate with power. Some of the directors general, for instance, had more influence over decision making than the deputy minister did, and they acted as if they were equals, not subordinates, to the minister. "[Fayyad] wanted to get rid of these power centers, the ones that were not playing by the rules. These guys reported directly to the president and had alliances with security services, the president's office, the Fatah cadres, and the street," said al-Wazir.

The president himself had long dealt directly with many of these people, bypassing the minister and undermining the lines of authority needed in an impartial and effective bureaucracy. When Fayyad began his job, there was no bureaucratic structure. Some staff members had their own agendas and used their positions to grant favors and build followings. "It was kind of like a mafia, really," al-Wazir said. "There's this mafia and that mafia, and three, four mafias in the ministry."

Fayyad knew he had to define roles and reporting relationships if he was going to be able to assert his own authority and bolster accountability. But first, he had to figure out how work flowed in the ministry and who did what. One tactic was to study the mail. At the time, requests from citizens and from other government offices to the finance ministry arrived daily by post. (Many of the requests were administrative and routine; paper was the PA's main medium of communication.) How that mail was routed internally, who replied, and how they replied offered clues about who did what in the ministry.

Every night during his first few months on the job, Fayyad said, he hauled home shopping bags stuffed with letters and memorandums sent to his office. He skimmed each item and annotated it with questions or instructions. The next morning, he sent it back to its author or along to its next destination, tracking the movement of each item by way of a new archiving system.

Many of his instructions were meant to strengthen lines of authority and encourage the deputy minister, assistant deputy ministers or directors to delegate. If someone responded to Fayyad's questions or instructions without recommending courses of action and instead asking for guidance, Fayyad said he

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knew he could not rely on that person to take initiative and he would have to find someone who could. No government could function well if the ministers themselves had to deal with administrative matters and complaints all the time, he said: "If that's all you do, what about the people we are supposed to serve?" It was crucial to develop staff capacity to handle such tasks.

If a staff member offered a recommendation he accepted, Fayyad signed it and set the implementation process in motion. Anything that had legal implications went to the legal department for detailed review; Fayyad said that in order to set a model for others, he never overruled the legal department staff.

"When people talk about institution building, it is really processes like this that make a difference," Fayyad said. Working through the directors by asking them for the advice of their units was essential for building a culture of responsibility and accountability. A hierarchical communication system was important for coordination and efficiency as well as to prevent people from talking past each other or embroiling Fayyad in internal squabbles.

Soon the effort yielded valuable insights. When the directors to whom he had posed questions sent their recommendations back to him, Fayyad flipped to the end of the paperwork to see whose name was attached to the actual analysis presented. Such a practice helped him get to know individual staff members and their skills and capabilities. When workers came up for promotions, he would already have a good sense of whether the people were qualified. Gradually, he began to move into advisory positions or nonessential projects those who lacked the right skills, and he shifted better-qualified personnel to positions with more responsibility.

Fayyad also tried to model supportive leadership and attention to detail. As he got to know people in the ministry, he started to pencil advice on the memorandums before sending them back to their senders. For example, if a staff member had talent but risked offending others by pushing too hard, he might write: "'You need to go along. Be patient.' Nothing more than that," Fayyad recalled. Masri, the director of control and audit, said that "deputies would send their recommendations, reports, and needs, and Fayyad would read every word. He would even correct you if you had an Arabic grammar mistake. Sometimes I would think, 'When did he have time to find this mistake?'"

The mail project also helped curtail some of the so-called mafias that al-Wazir described. When someone with a reputation as a power broker showed up with a thick file of mail and said he needed the minister's approval but offered to save the minister time by handling it himself, Fayyad said he would insist on reviewing the correspondence and returning the file the next day. This practice constrained others from saying they were acting on the minister's behalf, and it consequently reduced their influence. Once the minister had affixed his initials, the self-styled deal brokers could no longer exact favors from the people whose work the letter affected. "The minute you sign, he cannot do anything with it," Fayyad said.[24]

The ministry did not save any money as a result of the mail project, but it became a more impartial and effective bureaucratic institution that started to

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display greater capacity. The outlines of an organization chart gradually appeared, reported the nonprofit Palestine Economic Policy Research Institute, which conducted a 2003 study to assist the ministry.[25] Al-Wazir was charged with formalizing it in 2004 (exhibits 1 and 2). Slowly, as lines of responsibility settled, people could operate in an environment in which everyone knew not only what was going on but also how and why.

Fayyad said, "It's seeing the work processes and who's doing what that really gets you to decide how you do certain things."[26]

Unifying operations

Because ministry operations were divided between Gaza and the West Bank, Fayyad had to spend part of each week in each location. There were personnel with specialized skills in Gaza, and the offices there had not suffered the same destruction the Israeli military had inflicted on the West Bank. At the time, Gaza was the ministry's real center and accounted for a little over 60% of its employees.[27]

Getting to Gaza from Ramallah, where Arafat stayed and where leadership meetings took place, was no easy matter. Because Israel had set up hundreds of checkpoints to control movement and sometimes closed the Gaza borders, travel between offices could take a long time and risked running afoul of curfews. To ease the trips, the aging green Hyundai with the missing hubcaps had to stay behind. Instead, Fayyad caught a taxi to the Gaza border. He then got out, crossed, and picked up a car on the other side—much the same drill he followed in commuting from his home in Jerusalem to the Ramallah office, when circumstances permitted. He carried a small suitcase wherever he went, uncertain whether curfews or closures might impede his return.

Fayyad first made this journey in June 2002, right after the government announced his appointment. He had watched a television interview with a senior finance official, a Gaza-based member of the Fatah revolutionary council who asserted the new minister would be powerless. The next day, he took advantage of a gap in the curfew to visit the ministry's Gaza headquarters, traveling with Arafat's chief of staff, Ramzi Khoury, who made introductions. This step, a demonstration of Arafat's backing of Fayyad, defused a possible revolt within the ministry and opened some space for Fayyad to get to work. Gaza was where the kingpins sat, and Fayyad had to quickly establish his authority with them.

Distance was not the only way in which geography separated Gaza and the West Bank, however. Accounts were classified on a regional basis; each territory had its own director general for each ministry function; the territories had different computer systems from one another and, usually, different policies. The two territories also had distinct legal traditions—one Egyptian and one Jordanian—which contributed to the proliferation of parallel offices for some functions. For instance, from 1948 until 1967, when Israel laid claim to both areas after the Six-Day War, Gaza was under Egyptian administration, whereas the West Bank was part of the Hashemite Kingdom of Jordan.

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Those differences influenced policy, especially with respect to taxation.[28] Al-Wazir said: "The tax guy in Gaza was different from the tax guy in the West Bank. That added to the complications."[29] Each territory had its own criteria for classifying and handling large taxpayers, and whereas Gaza imposed levies on agriculture, the West Bank did not. Other government systems also varied by location. For example, the payroll was automated in Gaza but manually generated in the West Bank. Even office rules and pension systems for ministry employees were different between the two territories, which fueled tensions between some staff members.

Differences in ideology and politics among residents of the two territories also affected the tenor of social relationships. International management-consulting firm Deloitte had reported only a year earlier that its accounting and auditing training had stumbled because of conflicts between West Bank and Gaza members of the professional associations for accountants, the pool of people who often interacted with the ministry.[30]

These divisions complicated the task of achieving the goals Fayyad had set out, especially institution building. Therefore, he began to reorganize, vesting control of each ministry function in the hands of a single director general rather than having one for each territory. In some instances, that step required parallel changes in procedures and laws. For example, during the coming months, the ministry's legal and tax departments collaborated to draft the first uniform tax law that would apply to both Gaza and the West Bank. The step eventually enabled the ministry to combine all tax operations under one administration, created the capacity to cross-check filings between indirect and direct taxes, and facilitated better identification of delinquent payers.[31]

The effort to unify the territories extended to data. Fayyad decided he did not want the ministry's public information on revenues and expenditures to reflect geography. "I didn't want people looking at the numbers and saying, as you would expect them to say, 'Well, how come we're *paying* and they're *spending*?'" he said, referring to the possibility that tax revenues collected in one area might support government programs in the other.

In addition, the ministry began to take on the difficult task of unifying and rationalizing pension systems. At the time, the West Bank had a pay-as-you-go system with a low employee contribution. But annual outlays consistently exceeded contributions, and the government had to make up the difference. Gaza had a high employee contribution and a surplus, though the finance ministry estimated it would start to run a deficit in a few years because the government had stopped making contributions. Those differences created disparities in the benefits people like teachers received because the benefits depended on whether the teachers lived in the West Bank or Gaza. Retiring West Bank teachers received only about US$70 per month, Fayyad said—not enough to live on. As part of a planned overhaul, he raised the benefit level in the West Bank to enable teachers to retire, thereby opening posts for a new generation of instructors (text box 2).

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Text Box 2: Addressing Pension Liabilities

The PA was operating different pension systems for each of the West Bank and Gaza when Fayyad came to office in 2002, and neither provided financial disclosure—no audits, no annual reports. The security services had no pension system at all, even though employees had been paying 10% of their salaries for a pension benefit since 1995. The World Bank estimated the government's total arrears to the pension schemes to be US$170 million in 2003.[1]

In addition to the risks that pension liabilities created for the government budget, the inadequacies of the pension system made it hard to induce people to retire on time and to reform the civil service and security organizations.

Fayyad set up a pension project coordination unit in the finance ministry to oversee the development of a new pension system and prepare a draft law for the legislative council to consider.[2] In preparation for a new national system, the two schemes were audited in 2003, and negotiations began in order to stipulate retirement age, define years of service for eligibility, devise an inflation-adjusted formula, and develop other elements.

[1] World Bank, *West Bank and Gaza, Pensions in Palestine: Reform in a Context of Unrest*, Report No. 25046-GZ, February 28, 2003.
[2] International Monetary Fund, Macroeconomic and Fiscal Developments, Outlook, and Reform in the West Bank and Gaza, Ad Hoc Liaison Committee Meeting, December 8, 2004, p. 16.

Strengthening capacity

Because Fayyad could not bring in new people from the outside, he worked to build capacity from within. The ministry had 1,722 employees at the time, according to its own records., a number that would rise slightly over the coming months as functions then housed in other parts of the government moved under the ministry's control.[32]

The personnel who had served in the Israeli Civil Administration, the Ministry of Defense department that coordinated civilian and military activities in the West Bank, were competent accountants, but neither they nor those who joined from the PLO had significant experience in preparing a public budget or presenting it for review by ministers and the legislature, concluded Palestinian scholars Yezid Sayigh and Khalil Shikaki, authors of a 1999 report outlining a reform agenda for the PA.[33] The personnel lacked skills in planning and forecasting as well.[34] A 2001 analysis by Stanley Fischer, deputy managing director of the IMF at the time, identified some of the same weaknesses, noting in particular, "All areas of budget preparation, monitoring and execution need significant strengthening."[35]

Fayyad said he was skeptical of drawing on the help of foreign technical assistants, who too often just did the work themselves instead of teaching others to do it. He recalled that the ministry had four such assistants when he arrived, and he phased them out. Later, he let the ministry host international advisers for some functions and only on a short-term basis as time went on.

To build capacity without subverting the rule-governed centralized authority and accountability system he was trying to put in place, Fayyad asked deputies and directors to allow him to train more-junior staff—usually in Gaza after the workday ended. (West Bank employees remained under curfew.) A few weeks after becoming minister, he began to lead internal workshops stressing

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both technical skills and concern for how government operations affected ordinary Palestinians. "It was a fabulous opportunity for me to get to know people," he said.[36] The staff worked hard, he added. "They willingly worked overtime, late hours."

Some of the workshops built knowledge of the budget process: preparation, what goes into a budget circular, how to generate appropriate tables, how to assess the previous year, and how to deal with macroeconomic developments on the horizon. "We discussed the ceiling—how much you expect nominal GDP to grow—and then expenditures, estimated on a historical basis," Fayyad said. Economics training at Middle Eastern universities was weak when it came to students' building their familiarity with macroeconomic analysis and quantitative methods, Fayyad said, so some of the workshops focused on those subjects.

In the process, Fayyad and the junior staff began to solve problems. For example, the data the ministry reported did not adhere to the IMF's Government Finance Statistics guidelines. Plus, the PA did not compute wages correctly, and the method it used for reporting expenditures and revenues understated both. Those departures were fixable, and in the process of making the adjustments, staff members began thinking about the ministry's information system less as something they had to keep up-to-date and more as a means of achieving what they wanted to accomplish.

"Learning the logic helped people feel included," Fayyad said. "They began to feel they were not just pencil pushers but were also involved in the thinking." Junior staff from the budget, treasury, and payments offices were the most-eager participants, and many became managers later, he said.

Masri said the training program was one of Fayyad's real successes: "He did it smoothly, and he did it without creating problems, but he was very firm in his decision that we had to change. We needed to have new blood or more-professional people." Fayyad later enlisted outside help to conduct some of the instruction related to Masri's area: internal audit. For example, the Palestine offices of London-based consulting firm Ernst & Young led a short course on how to audit payroll. Ministry employees who participated in the course helped directors identify gaps and mistakes in their processes and procedures and eventually enabled the ministry to create a better system.

Over time, the efforts began to pay off, al-Wazir said, recalling that after he became deputy minister and then acting minister following Fayyad's departure in 2007, "The number threes, the number twos—when I promoted them to positions [later] they did a good job."[37]

Another way to build capacity and change the culture was to show how values could shape project decision making. Early in Fayyad's tenure, for instance, the ministry had to decide how to prioritize overdue payments the PA owed its suppliers. In theory, the PA could decide to pay off its biggest debts first, but that option likely would favor big companies that had substantial cash cushions. Fayyad saw a clear opportunity to lead by example. "Instead, we decided to spread the little money we had as wide as we possibly could by paying first those who were owed the smallest amounts," he said. That approach

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enabled the government to repay the people who were probably most injured by the delays while also reaching more of them—and underscoring the government's commitment to serving all Palestinians.

"So we set this macro rule, and I said that until the deck is clear, checks under a certain amount—say US$100—this week we will pay those," Fayyad said. "Gradually, we raised the level a little bit at a time"[38] as the backlog eased. "The little money you have, you are reaching a lot of people, and in the process, what's happening? Reform is really beginning to have an impact. It's not just a word anymore. People relate to it as something good. 'Oh, I'm getting paid! I don't have to bribe someone to get what I am owed!'"

Early in his tenure at the ministry, Fayyad also worked with his staff to put the PA's monthly revenue and expenditure information online, with the aim of doing the same with the 2003 budget after it was complete. Transparency was vital to good governance, he reasoned, because it helped the legislature and the public hold the ministry accountable; it enabled everyone in the finance ministry to understand what their own institution did; and, eventually, it would help quell rumors about who was doing what with taxpayer money. Moreover, the PA could show itself a leader; no other Arab country had at the time meaningfully or adequately opened its budgets to public scrutiny.

Sorting fact from fiction

Getting a grip on the Palestinian Authority's fiscal challenges required data Fayyad did not have when he arrived at the finance ministry. For years, the PA had no functional system for recording extrabudgetary expenditures. That lack, coupled with other anomalies, rendered pre-2002 information on the PA's finances unreliable. Those data problems inevitably affected international reporting, which Fayyad said, "often suggested a degree of exactitude that simply was not there."

One of Fayyad's goals as minister was to boost data quality so that he and his successors could manage fiscal affairs effectively. Reliable reports were also important for the diplomatic negotiations the president conducted.

During the period since the Palestinian Authority's inception in 1994 through 2003, the IMF reported on the Palestinian fiscal situation and fiscal prospects in quarterly reports based on data provided mainly by the finance ministry. The ministry-provided data on expenditure were aggregated into three main categories: wage expenditures, nonwage operational expenditures, and transfer payments. The data on revenues were aggregated into two main categories: domestic revenues and clearance revenues (the portion of the PA's revenues—nearly two-thirds—that the government of Israel collected on behalf of the PA under the protocol on economic relations between the two sides). The ministry also provided monthly data on the number of PA civil-service and security-service personnel, as well as the use of an overdraft facility the ministry had with a commercial bank. For its part, the IMF also collected data on donor funding and associated development expenditures.

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Based on that information, the IMF calculated the *recurrent* fiscal balance (the difference between the PA's own total revenues and its total current expenditures) and the *overall* fiscal balance (the difference between total revenues and total expenditures, including development expenditures). Of the two concepts, the recurrent fiscal balance was of much greater interest because it indicated the amount of donor funding the PA needed to meet operating expenses. Donors were not keen on addressing that need because it essentially meant paying support into the PA's treasury.

Several gaps made the ministry's statements and IMF reporting highly challenging and not necessarily reflective of the underlying fiscal position. Key among the gaps were that (1) not all of the PA's revenues were channeled to the treasury, and (2) the finance ministry did not include those as part of the revenue take. Of the diverted revenues, petroleum excises were known because they flowed through Israeli companies, and the IMF obtained the relevant data on them from the Israeli finance ministry. As a means of putting pressure on the PA to account for those revenues, the IMF included them in its quarterly reports. What the IMF could not report on, however, were the PA's outlays that those revenues financed. That gap had the effect of understating both the recurrent deficit and the overall deficit because revenues for which there was no corresponding expenditures were included.

Before he became minister, Fayyad, like other economists, considered data on donor financing of the recurrent budget deficit a better gauge of the PA's actual fiscal position than the expenditure and revenue data provided by the finance ministry. Now Fayyad had the authority to improve financial reporting so that the PA could plan better and secure release of the PA revenues withheld by Israel, revenues that were key to resolving the authority's financial crisis. Transparency and accountability were crucial for winning international support, especially backing from the United States and the European Union.

In addition to redesigning procedures in order to provide better information, Fayyad helped train staff to handle the preparation and dissemination of regular monthly reports on the PA's fiscal operations.

Ensuring future accountability

Fayyad said he took it as part of his mandate to help the legislative council and other parts of government learn how to hold a finance ministry to account. He had an institutional interest in providing such assistance because attentive oversight—especially on the part of the legislature—was essential for sustaining reform after he left. He said it also enabled him to turn around and say to powerful potential spoilers that his hands were tied in regard to many actions: "Look, I had no choice; the ministry has to heed the [legislative council's] requirements.

"I would invent an opportunity to brief the budget and finance committee of the legislative council," Fayyad said. The point was partly to show deference to the council and partly to make sure people understood that his initiatives were not aimed at centralizing systems so that he, the minister, could do whatever he

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wished but, rather, were meant to establish the groundwork for policies that would serve ordinary Palestinians better. If the budget committee did not ask him to meet often enough, he said, "I'd phone them up and say 'Hey, you haven't called me in a long time.'"[39]

Although many members of the legislative council were outspoken in the need for reform, they were relatively uninformed about fiscal policy and sound financial management practices—and without such knowledge it was hard for them to do their jobs well. Fayyad worked to explain financial matters and answer questions. "Before long, you had parliamentarians who talked about the organic budget law and what can happen and what cannot happen. They spoke like authorities," he said.

Civic groups could provide an additional form of accountability, but they too needed information and a strong understanding of how government finances worked. In a step to support them in that role, as well as to enhance the legislature's capacity to do its job, the finance ministry began to post on its website monthly budget execution reports and expanded public information in 2003.

International best-practice standards also stipulated that a government should have an independent general auditor, sometimes called a *general accountability office* or *inspector general*. An effective independent audit institution was an important adjunct to the finance ministry's own efforts to ensure that money allocated to ministries served the intended purposes. It also would review the ministry's financial statements annually according to internationally accepted standards.

Although the PA's General Control Institute was supposed to fulfill that role, it was neither independent nor effective at this point. Established in 1997, the institute was attached to the president's office instead of the legislative council, so it was potentially open to partisan pressure. Furthermore, the president could exempt organizations from the institute's scrutiny.[40] The institute had no mandate to audit either the president's own office or the security services, and it had no clear standards to adhere to in its work.[41]

As time went on, the World Bank's Financial Management Reform Trust Fund provided support for the legislative council to draft a law establishing an independent authority answerable to the legislature.[42] However, it would take until 2005 to set up the new institution, called the Financial and Administrative Control Bureau, and to approve a new External Audit Law.

Redelegating

About 18 months after becoming finance minister, Fayyad judged that the ministry's capacity had grown and that lines of responsibility had settled into place. With those gains secured, he said, he could redelegate some of the authority he had centralized and prepare for his eventual departure from the ministry. He recruited al-Wazir, then a senior officer in the planning ministry, as deputy minister, promoted some junior personnel to director general roles, and handed over to others the responsibility for tracking implementation progress.

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Al-Wazir said he initially hesitated to accept the job, pointing out that he had no background in public finance, but Fayyad prevailed. "To my shock, the next day he gave me signature authority," al-Wazir said, referring to the power to sign government commitments. "What happened was that at the time, the ministry was Salam. As long as he was in his office, he could sign on taxes, transfers, salaries, everything. But the minute he stepped out, the ministry essentially closed. There was no one else to sign things. It was just him and his suitcase. The suitcase was either out or the suitcase was in."

Fayyad started to take al-Wazir to all of his meetings, and al-Wazir began meeting with international missions that came to visit, gradually assuming responsibility for external relations. Fayyad sought his new deputy's counsel on important matters, assigned him responsibility for creating an organizational chart for the ministry and for restructuring some departments, and asked him to sit in on meetings about reform of other ministries and agencies so he could assess the cost impacts of their proposals.

A handover was in the offing. "I wanted to set an example," Fayyad said. "This is not about becoming powerful; this is about doing the right thing and then moving on."[43] He planned to step down from the job and said he was eager to turn authority over to others.

During the period they worked together, al-Wazir said, he quickly came to see how fraught the job was. He and Fayyad constantly had to find ways to deliver civil service salaries when the PA's coffers were empty. And he also came to appreciate the power of vested interests. Fayyad "needed a lot of political support to deal with the vested interests," he said. "These guys had a lot of alliances with security services, with the president, with the people around the president, with the street, with Fatah, and with the Tanzim," a hardline militant faction of Fatah.[44]

OVERCOMING OBSTACLES

Managing relationships both interpersonal and institutional was one of the most difficult parts of Fayyad's job. Given the unusual circumstances that prevailed in the occupied territories and the tenuousness of his position as a perceived outsider in the PA leadership, Fayyad often had to walk a fine line to maintain the political support necessary for implementation of his mission of remaking the finance ministry. Just five months into his position, an unexpected situation arose that demonstrated just how difficult walking that line could be.

In November 2002, Arafat, without consulting Fayyad beforehand, declared he would pay PA salaries on Eid, the religious holiday that marks the end of Ramadan, a date that would fall in early December that year. Not only did the president's directive undermine the institutional processes and independence of the finance ministry, but it was also impossible. The PA did not have the money to pay salaries by Eid. Israel was still withholding the territories' revenues. And the finance ministry had already done all it could to partially pay the salaries of government workers and to meet other essential obligations, such as to provide

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some funding for the long-ignored social affairs ministry, which served the poorest families.

The president proposed to draw from the pension fund—which already was headed toward insolvency—and to borrow via the Palestine Monetary Authority (PMA), the central bank of the Palestinian Authority. The commercial banks were reluctant to lend the PA more money because the PA already owed them US$40 million it had borrowed to pay salaries during the previous months.[45] The banks were required to deposit a portion of their reserves with the PMA, but that money was not the central bank's to lend. If the government forced the PMA to lend those reserves, it would have destroyed confidence in the integrity of the banking system. "I was vehemently against it," Fayyad recalled.

Fayyad knew he was in a difficult position. His mission to build a professional finance ministry was possible only if he maintained Arafat's support. Opposing the president over the salaries would imperil that support, yet going along would undermine the mission. There was a third way that seemed a long shot, but Fayyad realized it might be his only option: get Israel to release revenues it had withheld.

Back in June, US President George W. Bush had declared support for "two states, living side by side in peace and security."[46] To reach that point, he urged both the Palestinians and the Israelis to break with the past. But Israeli Prime Minister Ariel Sharon, who had won election in 2001 on a platform that opposed Palestinian statehood, insisted on cessation of all violence as a prerequisite to cooperation with the PA.[47]

At around the same time, Fayyad, in only his second week as minister, received an invitation from US ambassador to Israel Daniel Kurtzer to meet with the head of Civil Administration in the Israeli government at Kurtzer's residence. As Kurtzer would later tell Fayyad, he had noticed that Fayyad had put the PA's expenditures online during his first week on the job—a gesture of transparency that made the ambassador think the two sides might be able to negotiate a solution to the revenues issue. With Arafat's permission, Fayyad accepted the invitation and discussed with the Israeli official the possibility of releasing the revenues. That meeting led to further meetings in the subsequent months between Fayyad and other Israeli officials.

At the same time, Fayyad put pressure on the Americans to push the Israelis to release the revenues. The Bush Administration had followed up the president's June statement with a diplomatic push to resolve key sticking points between the Israeli government and the PA. At a mid-October meeting with Bush, an Israeli delegation headed by Sharon agreed in principle to lift some restrictions on Palestinians and transfer revenues without the PA's achieving all of the many benchmarks and conditions Israel had previously laid down. However, the Israeli government would release funds only if it approved how the PA intended to spend them, said Fayyad, a position the PA could not accept.

At the beginning of December, on the verge of Eid, the situation seemed desperate. Sharon gave a speech in which he said the establishment of a

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Palestinian state was in Israel's interest, a shift in perspective, and he agreed to recognize the need for a two-state solution to the conflict.[48] But again he said that Palestinian statehood was contingent on various reforms and changes that were nonstarters for the PA, such as Arafat's removal from any leadership role.[49] Sharon also said "taking the financial system out of Arafat's hands, and appointing a strong finance minister with authority, constitutes an important factor for stopping the terrorist system operated by the Palestinian Authority," a statement that threatened to undermine Fayyad's credibility with his fellow Palestinians.[50]

Still trying to secure the funds to pay salaries, as the president wished, Fayyad kept prodding the Americans to pressure the Israelis. But as noon approached on the day before Eid, it became clear to Fayyad that the money was not going to come through in time. All morning he had dodged calls from the president, who was demanding Fayyad sign the paper that would order the banks to stay open on the holiday so they could disburse the salaries.

"I knew I was in trouble," recalled Fayyad. He decided to speak with the president in person, but before doing so, he pulled out a piece of paper and wrote a resignation letter, prepared to offer it to Arafat if the president berated him or demanded it. In the car on the way to Arafat's office, Fayyad called in for a radio interview during which he announced that the government was not going to be able to pay salaries on Eid as promised.[51] He explained that "the decline in revenues, drop in aid, and Israel's withholding of our money has left us unable to work normally," reported the Arabic-language *Al-Quds* newspaper.[52]

When Fayyad arrived at Arafat's office, the president was alone. To Fayyad he appeared angry. He told Fayyad they had to sign the letter ordering the banks to stay open. Fayyad told him that wouldn't be necessary, that he wouldn't support drawing from the pension fund or forcing the PMA to lend out the bank reserve funds it held. Fayyad recalled telling Arafat, "'I honestly believe it will be a lot better for you to be remembered as someone who really cared this much about paying but decided not to because it was the wrong thing to do.'" He added, "'It would be much better, as we are building a state, for people to think during these darkest of days that the real person in authority decided—in the interest of setting a good tradition—to forgo the payment in favor of getting things right and doing the right thing.'"

Fayyad braced for an outburst of anger, but instead, Arafat said nothing. "After long minutes of complete silence had passed," Fayyad recalled, "I left the room quietly and with sadness that I had to let the president down." The resignation letter was still in his pocket.

Fayyad traveled back to the ministry, stewing over what he saw as US reluctance to pressure Israel hard enough to secure the revenue transfers. On his arrival at his office, an assistant told him that acting US Consul General Jeff Feltman was on the telephone. Feltman said he needed Fayyad's fax number in order to convey a letter from Sharon's chief of staff, Dov Weisglass, who had been a primary interlocutor in the negotiations over the revenues.

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Fayyad recalled that he felt all the "anger and frustration and sorrow" of the ordeal rush to the surface, and he yelled at Feltman over the inability of the Americans to help deliver on the revenues. "I became unglued, really, really mad. I told him something like, 'All this time we've been looking for money, and you're calling me for a fax number!'" he recalled. "Then I was saying all these horrible things to Jeff Feltman about how bad the US administration was."

The next morning, Fayyad was scheduled to attend a meeting with two US senators, at which Feltman was present. After the meeting, Feltman took Fayyad aside and said, as Fayyad recalled, "You're going to get some money from Israel today."

Feltman explained that US National Security Adviser Condoleezza Rice—prompted, Fayyad would later speculate, by hearing of Fayyad's outburst with Feltman—had been on the phone with several people in the Israeli government through much of the night. Although one of Sharon's cabinet officers had wanted to wait to release the PA's revenues until after Israeli primary elections in order to avoid alienating right-wing voters, Rice had apparently persisted. The money—135 million shekels (about US$35 million)—would be in the account of the correspondent bank, which would then transfer the funds to the PA's account at the Arab Bank.

Around 11 a.m. on Eid, Fayyad called the Arab Bank's treasurer, a former associate, and asked him to check. The money was there. Fayyad went to see Arafat. Alone with the president after his staff left the room where Eid lunch had been served, he told the president the news of what had transpired the night before. Not much was said, Fayyad recalled, as "the president was visibly moved while nodding approvingly."

Though only a one-off operation, the revenue transfer eased the PA's severe liquidity crunch, enabling it to pay salaries after the Eid recess. What was perhaps more important was that it validated Fayyad's reform mission by demonstrating that proper fiscal and governance practice could pay off. "This episode gave [us] something to build on," Fayyad said. "[It helped show] that doing the right thing could produce good results."

It would take two more months and many Kurtzer-mediated rounds of negotiations before the Israeli government agreed to release the remaining withheld Palestinian revenues and to resume the regular monthly transfers. The Israelis' starting position was that they would keep the money but disburse it themselves to entities based on an itemized list that Fayyad was to submit to the Israeli treasury. For his part, Fayyad argued that, by withholding the Palestinian revenues, Israel was contravening the Paris Protocol and that it should therefore release the funds unconditionally.

In the end, the US administration tabled a bridging proposal according to which the money would be released, but the PA outlays would be audited by an international accounting firm. Having already used an international accounting firm to help train ministry staff, Fayyad accepted the US proposal. Israel initially rejected it outright but relented in December 2002 after persistent and intensive

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US diplomacy that highlighted the success and pace of Palestinian reforms over the span of a few months.

The hard-won victory, however, may have weakened Fayyad and his reform project politically. Remitting the PA's revenues contingent on meeting an imposed international standard made it easy for some of Fayyad's compatriots to claim that his reforms merely acceded to the demands of an occupying power. It didn't help that Sharon had expressed support for the kind of reforms Fayyad was trying to implement—or said that a "strong finance minister with authority" was in Israel's interest.

ASSESSING RESULTS

In 1999, nearly four years before Fayyad became finance minister, an independent international task force produced a stark portrayal of the reform challenges the PA faced. The study, authored by two Palestinian scholars and called the Rocard report—for the former French prime minister who, together with Henry Siegman, president of nongovernmental organization the US Middle East Project, co-led the task force—said: "It must be recognized that the Palestinian Authority has had to establish and operate effective public institutions in a short time span within a framework of limited territorial jurisdiction; geographical fragmentation; nonsovereign control over land, population, and natural resources; and stringent security obligations . . . The time span and framework have often impeded the development of optimal institutional structure and proper practice."[53]

Fayyad became finance minister in June 2002. In the middle of August that year, Fayyad announced that his ministry had already completed the main elements of the 100-day reform plan—a month before the deadline.[54] (See other ISS cases in this series.) By 2004, Fayyad had also made substantial progress on changes to help build capacity, standardize procedures and protocols, and improve performance within the ministry. And the ministry had assimilated personnel from other parts of the government—such as payroll, the Petroleum Commission, and the Tobacco Authority—that were now incorporated in the ministry.

Fayyad had initially centralized control within the ministry as part of an effort to build a rules-governed, accountable institution. A 2003 survey of finance personnel conducted by the Palestine Economic Policy Research Institute, a nonprofit organization, captured a picture of that transition. Some of the comments suggested that people who had previously wielded power chafed at their reduced autonomy under the new procedures. The institute reported "the top managerial level of the MOF [Ministry of Finance] is highly centralized and does not delegate powers. There is competition for responsibilities and lower administrative levels are not given the freedom to develop their internal and external communications."[55] Although the study's authors voiced concern, to Fayyad the observations suggested that the changes he sought were indeed under way and fiefdoms were disappearing.

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Text Box 3: Scoring the Finance Ministry's Performance

The Public Expenditure and Financial Accountability (PEFA) program, launched in 2001 by seven international development partners, offered a framework for assessing the strengths and weaknesses of government financial management by using quantitative indicators. The PA's first assessment, conducted in 2006 during a period of political turbulence and after Fayyad stepped down, pointed to a need for further improvement but also to important accomplishments during the previous years. On a scale in which *A* signaled strong performance and *Unrated* indicated failure, the PA earned a few *B*s and *C*s that represented significant improvement over 2000–2001. Some of the improvements were:

- The congruence between actual expenditures and allocations in the approved budget.
- Better information for the monitoring of payment arrears
- Comprehensiveness of the information included in budget documentation
- The extent of extrabudgetary expenditure unreported (the PA earned an *A* grade for leaving little unreported)
- The extent of central monitoring of government agencies and public enterprises in order to identify fiscal risk
- Improved public access to fiscal information
- Compliance with controls on nonsalary expenditures
- Effectiveness of the internal audit
- Quality and timeliness of the in-year budget report
- Orderliness of the annual budget process

World Bank, "Gaza and West Bank Public Expenditure Review: From Crisis to Greater Fiscal Independence," vol. 2, March 2007, pp. 180–95. The Public Expenditure and Financial Accountability ratings began to become publicly available for most countries only after this point. Data for Jordan and other countries appear at the PEFA site https://www.pefa.org

After al-Wazir joined the ministry and Fayyad began to redelegate, roles gradually settled, although the degree of autonomy employees had exercised earlier yielded to insistence on new systems and new work processes. There were several other notable institutional changes as well, including greater transparency in sharing information about revenues and expenditures and ending the practice of maintaining two sets of data—one for Gaza and another for the West Bank—a move that reinforced the vision of unified Palestinian statehood.

A 2006 World Bank expenditure review captured some of the institution-building progress. The report summarized the PA's scores on a public expenditure and finance accountability rating system that international institutions used for assessing country performance. Many functions received average *C* ratings that nonetheless placed the PA's finance ministry above many conflict-affected countries and, with respect to some elements, on a par with scores that Jordan achieved at roughly the same time.[56] Under the turbulent conditions that prevailed in the occupied territories, those ratings indicated significant progress (text box 3).

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Salam Fayyad's dedication to the value of creating an enduring bureaucracy—in the positive sense of the word, with rule-governed systems and processes that improved capacity, responsiveness, and accountability—helped drive reforms initiated during 2002–05. However, the strategy for implementing the changes had to be flexible and pragmatic—under conditions that prevailed in a conflict-affected setting.

"Most of what I did was not really the product of clear meditation, of sitting and deciding on a strategy," Fayyad recalled in 2019. "It's a point of strength, but it's also a point of weakness . . . almost always a product of necessity. You go there every day and try to do the best you can; do something good, however little it may be. If it is doable, if it's something you can accomplish, then just do it, keeping in mind core principles."[57]

Fayyad said his approach rested on a number of maxims—or rules of thumb—and a heavy dose of common sense, as follows.

1. Focus on the future, not the past.
2. Articulate a vision to help people understand why you have asked them to achieve the goals you have given them.
3. Improve work processes to rejuvenate an institution and enable other things to fall into place. In a turbulent or conflicted-affected community, it is better to create a new system and then enforce compliance than to punish people for past behavior.
4. Insist on respect for bureaucracy—clear lines of authority and impartial decision making according to established rules—in order to enhance effectiveness and prevent infighting.
5. Set an example by going to work early and never relaxing; others will follow.
6. Never forget that you are working to help others, whether they are employees or citizens in the streets. You are there to serve, period.

Fayyad's sixth maxim was integrally linked to the others. In October 2002, when he first met US National Security Adviser Condoleezza Rice, Rice pointed to Fayyad's decision to pay arrears to small suppliers first rather than compensating the biggest creditors. Fayyad said, "She told me that's what really caught her attention. She saw it as very democratic and pro-poor." Another example of that orientation was Fayyad's decision to pay stipends to long-neglected welfare recipients before paying employees who were most visible and loudest in their demands.

Fayyad stressed that Yasser Arafat had played a significant role in facilitating the reforms put in place from 2002 to 2005, even if the president rarely issued full-throated endorsements for changes to the ways the Palestinian Authority handled business and finance. "Most of the basic elements of a well-

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functioning public finance system were in place before Abu Ammar [Arafat] died, and they were put in place under his watch, some with his approval and cooperation, most with his full knowledge, a few with difficulty. We need to give Abu Ammar the credit he is due. It wasn't as if we turned a page and entered a reform era in November 2004, after his death."[58]

Yasser Abed Rabbo, a PLO stalwart and fellow minister, stressed that Fayyad's background and experience were key factors behind his success in recasting the ministry: "That was Fayyad's secret. He knew the old departments. He understood them. He had solutions in mind, but he did not come from outside. He came as 'I'm one of you,' and he proved that. He worked to help Arafat see why a policy made sense for Arafat, not for the international community."

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Exhibit 1: Finance Ministry Structure, 2002

There was no official organizational chart of the ministry at the time. However, operations were loosely grouped into 10 functional divisions as follows.

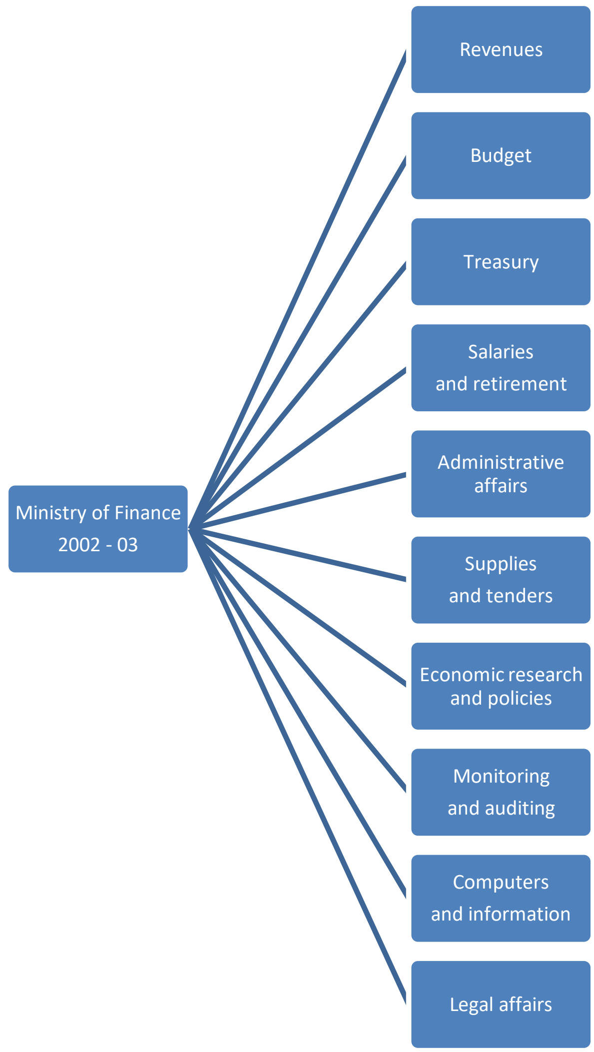

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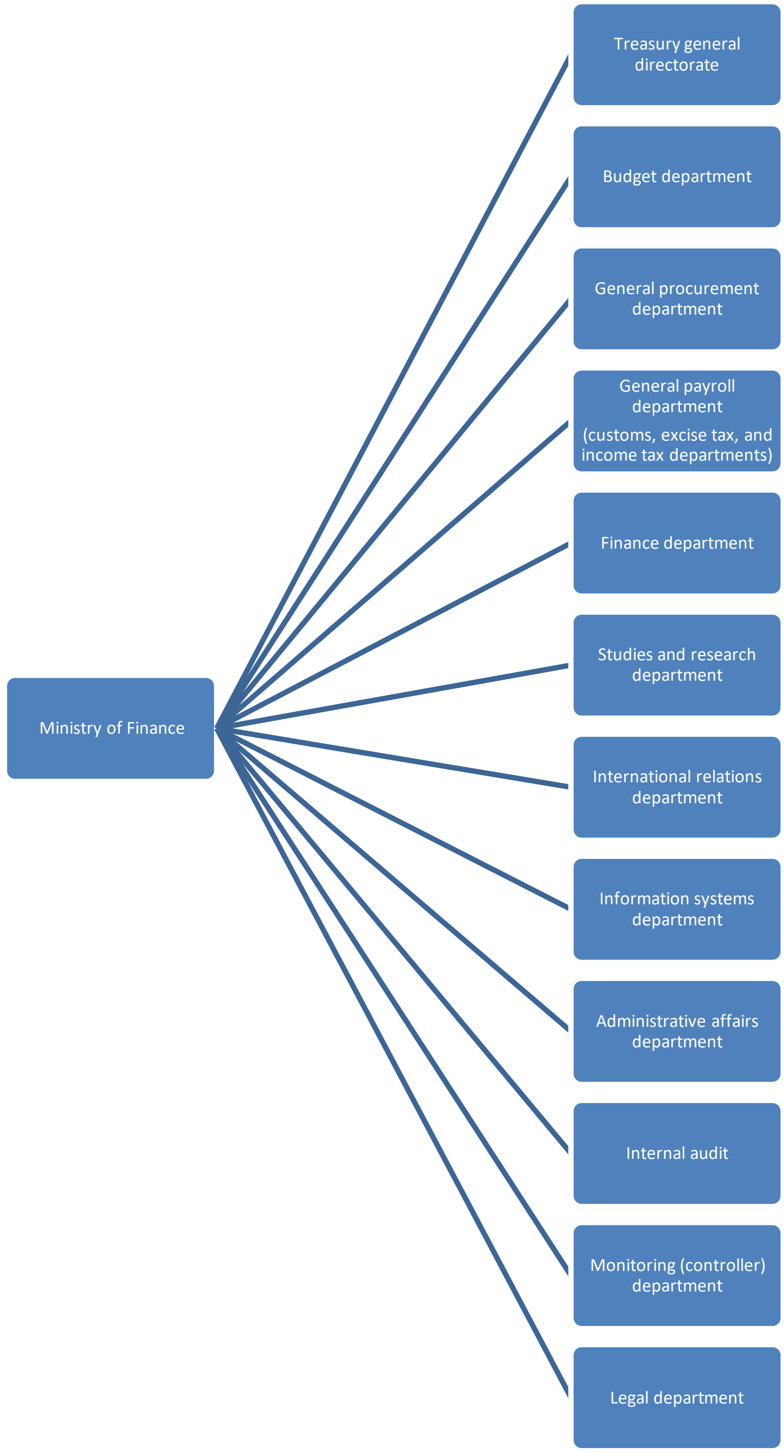
Exhibit 2: Finance Ministry Structure, 2004



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[6] A Bennett, K Nashashibi, S Beidas, S Reichold, and J Toujas-Bernaté, "Economic Performance and Reform under Conflict Conditions," International Monetary Fund, West Bank and Gaza, September 15, 2003, p. 68. The text uses the current balance in table 4.2. Figures before 2002 vary depending on what the PA decided to include in income and expenditure. Beginning in 2002, the finance ministry began using a standardized method for computation of the current balance.
[7] A Bennett, K Nashashibi, S Beidas, S Reichold, and J Toujas-Bernaté, "Economic Performance and Reform under Conflict Conditions," International Monetary Fund, West Bank and Gaza, September 15, 2003. "While the government's revenues dropped, payroll costs continued to rise. The president and other leaders had tried to use public employment to accommodate allies, refugees, and more recently, those who lost jobs in Israel or in the private sector. The wage bill, when paid in full, took over 50% of budget, and security consumed much of the rest."
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